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Dodd-Frank Wall Street Reform and Consumer Protection Act**MORTGAGE BANKING ALERT**

This Alert provides only general information and should not be relied upon as legal advice. For more information, contact your Patton Boggs LLP attorney or one of the lawyers/authors listed below.

Richard Andreano
202-457-7517
randreano@pattonboggs.com

John Socknat
202-457-7513
jsocknat@pattonboggs.com

Michael Waldron
214-758-3436
mwaldron@pattonboggs.com

WWW.PATTONBOGGS.COM

On July 21, 2010 President Obama signed into law the comprehensive financial reform legislation entitled the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The focus now shifts to the drafting of numerous regulations mandated by the Dodd-Frank Act, and construction of the newly established Consumer Financial Protection Bureau (CFPB). This Alert summarizes various provisions of the Dodd-Frank Act that will affect how the residential mortgage industry operates for the foreseeable future. Regulators must now decide how to best implement the law, with the aid of a follow-on technical bill to be released later by Congress.

Consumer Financial Protection Bureau. The Senate's version of the new consumer financial protection regulatory agency, the CFPB, survived in the Dodd-Frank Act. A new, independent Consumer Financial Protection Bureau (CFPB) is established within the Federal Reserve Board. The CFPB will be led by a Director who is appointed by the President and confirmed by the Senate for a five-year term. The CFPB will have broad authority over a wide-range of consumer financial products and services, including mortgage lending. For purposes of the CFPB, the "business of insurance" and "electronic conduit services" are expressly excluded from the term "financial product or service."

The powers of various other federal agencies with respect to consumer financial protection will be transferred to the CFPB on a date to be established, which is termed the "designated transfer date" (see below). In general, the CFPB will have authority over a "covered person," which is defined as any person that engages in offering or providing a consumer financial product or service and any affiliate of such a person if the affiliate acts as a service provider to such person.

- *Designated Transfer Date.* Within 60 days of the Dodd-Frank Act becoming law, the Secretary of the U.S. Department of Treasury (Treasury), in consultation with other agencies, shall establish the designated transfer date. The designated transfer date must be no earlier than 180 days and no later than 12 months after the date the Dodd-Frank Act became law. However, if Treasury determines that appropriate implementation is not feasible within 12 months and takes appropriate steps, the deadline for the designated transfer date may be extended up to an additional six months.
- *Review of Regulations.* Any member agency of the Financial Stability Oversight Council (Council), which is created by the Dodd-Frank Act, can petition for the Council to set aside a final regulation of the CFPB. The Chairman of the Council can stay the implementation of a final regulation of CFPB for up to 90 days to provide time for the Council to consider a petition.

- *Offices.* The Dodd-Frank Act requires the establishment of the following offices within the CFPB: Office of Fair Lending and Equal Opportunity, Office of Financial Education, Office of Service Member Affairs and Office of Financial Protection for Older Americans. The first three Offices must be established within one year after the designated transfer date, and the Office of Financial Protection for Older Americans must be established within 180 days after the designated transfer date.
- *Civil Penalty Fund.* The Dodd-Frank Act establishes a Consumer Financial Civil Penalty Fund (Penalty Fund). Civil penalties obtained by the CFPB will be deposited into the Penalty Fund and be made available to victims of activities for which civil penalties were imposed under federal consumer protection laws.
- *Disclosures.* The CFPB may prescribe rules to ensure that the features of any consumer financial product or service, both initially and over the term of the product or service, are fully, accurately and effectively disclosed to consumers in a manner that permits consumers to understand the costs, benefits and risks associated with the product or service, in light of the facts and circumstances.
 - *Model Forms.* The CFPB may include model forms in any disclosure rules. The use of a model form would be optional, although using a model form would provide a safe harbor for compliance with the applicable rule. Any model form must be validated by the CFPB with consumer testing before it is adopted. The CFPB may permit a covered person to conduct a trial program that is limited in time and scope, subject to specified standards and procedures, for the purpose of providing trial disclosures to consumers that are designed to improve upon any model form issued by the CFPB.
 - *Combined TILA-RESPA Disclosure.* Not later than one year after the designated transfer date, the CFPB must propose model disclosures that combine the initial and final disclosure statement required under the Truth in Lending Act (TILA) and the good faith estimate and HUD-1 settlement statement under the Real Estate Settlement Procedures Act (RESPA) into a single, integrated disclosure for mortgage loan transactions.
- *Unlawful Unfair, Deceptive or Abusive Acts or Practices.* The CFPB is authorized to prescribe rules to address unlawful unfair, deceptive or abusive acts or practices under federal law by covered persons in connection with any transaction with a consumer for a consumer financial product or service or the offering of a consumer financial product or service. The authority is similar to the authority previously granted to the Federal Trade Commission (FTC) in the Omnibus Appropriations Act, 2009.
 - *Unfair.* To find an act or practice to be unfair, the CFPB must have a reasonable basis to conclude that (1) the act or practice causes or is likely to cause substantial injury to consumers that is not reasonably avoidable by consumers, and (2) such substantial injury is not outweighed by countervailing benefits to consumers or to competition. This concept is based on the position of the FTC regarding what constitutes an unfair act or practice.
 - *Abusive.* To find an act or practice to be abusive, the CFPB must have a reasonable basis to conclude that the act or practice (1) materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or (2) takes unreasonable advantage of (a) a lack of understanding on the part of the consumer of the material risks, costs or conditions of the product or service, (b) the inability of the consumer to protect his or her interests in selecting or using a consumer financial product or service, or (c) the reasonable reliance by the consumer on a covered person to act in the interests of the consumer.
 - *Deceptive.* With respect to the grant of authority to address unfair, deceptive or abusive acts or practices, the Dodd-Frank Act does not define what is deceptive. The FTC considers an act or practice to be deceptive if there is a representation, omission of information or practice that is

likely to mislead consumers who are acting reasonably under the circumstances, and the representation, omission or practice is one that is material.

- *Seasonal Income Consideration.* The rules of the CFPB with regard to unlawful unfair, deceptive or abusive acts or practices must provide with respect to a credit transaction secured by residential real estate or a dwelling that if documented income of the borrower, including income from a small business, is a repayment source for the credit extension the creditor may consider the seasonability and irregularity of such income in the underwriting of and scheduling of payments for such credit.
- *Consumer Rights to Access Information.* Subject to rules prescribed by the CFPB (in consultation with the FTC), a covered person must make available to a consumer, upon request, information in the control or possession of the covered person concerning the consumer financial product or service that the consumer obtained from the covered person. The information subject to the access requirement includes information relating to any transaction, series of transactions or to the account, including costs, charges and usage data. The information must be made available in an electronic form useable by consumers. Certain exceptions will apply to the access requirements, and the requirement does not impose any duty on a covered person to maintain or keep any information about a consumer.

Risk Retention. Not later than 270 days after the date the Dodd-Frank Act became law, the federal banking agencies, FTC, Securities and Exchange Commission (SEC) and Federal Housing Finance Agency (FHFA) must jointly prescribe regulations to require any securitizer to retain an economic interest in a portion of the credit risk for any residential mortgage asset that the securitizer, through the issuance of an asset-backed security, transfers, sells or conveys to a third party. A securitizer will not be permitted to directly or indirectly hedge or otherwise transfer the credit risk that must be retained. The amount of credit risk retained must be:

- Not less than five percent of the credit risk for any asset:
 - That is not a qualified residential mortgage (see below) that is transferred, sold or conveyed through the issuance of an asset-back security by the securitizer; or
 - That is a qualified residential mortgage that is transferred sold, or conveyed through the issuance of an asset-backed security by the securitizer if one or more of the assets that collateralize the asset-backed security are not qualified residential mortgages; or
- Less than five percent of the credit risk for an asset that is not a qualified residential mortgage that is transferred, sold or conveyed through the issuance of an asset-back security by the securitizer, if the originator of the asset meets the underwriting standards prescribed with respect to the risk retention requirement.

A securitizer would not be required to retain any part of the credit risk for an asset that is transferred, sold or conveyed through the issuance of an asset-backed security by the securitizer, if all of the assets that collateralize the asset-backed security are qualified residential mortgages.

The regulations may provide for the allocation of risk retention obligations between a securitizer and an originator in the case of a securitizer that purchases assets from an originator, as the federal banking agencies and SEC jointly determine to be appropriate. In determining how to allocate risk retention obligations between a securitizer and an originator the federal banking agencies and SEC must:

- Reduce the percentage of risk retention obligations required by the securitizer by the percentage of risk retention obligations required of the originator, and
- Consider:

- Whether the assets sold to the securitizer have terms, conditions and characteristics that reflect low credit risk;
- Whether the form or volume of transactions in securitization markets creates incentives for imprudent origination of the type of loan or asset to be sold to the securitizer; and
- The potential impact of the risk retention obligations on the access of consumers and businesses to credit on reasonable terms, which may not include the transfer of credit risk to a third party.

The federal banking agencies, U.S. Department of Housing and Urban Development (HUD), SEC and FHFA must jointly issue regulations to exempt qualified residential mortgages from the risk retention requirements, and must jointly define the term “qualified residential mortgage,” taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default. The term may not be defined to be broader than the definition of “qualified mortgage” added to TILA by the Mortgage Reform and Predatory Lending Act, which is included in the Dodd-Frank Act (see below), and the regulations adopted with respect to the definition. Please see Repayment Ability Determination section below for a discussion of what is a qualified mortgage.

For asset-backed securities that are backed by residential mortgages, the regulations applicable to securitizers and originators become effective one year after the date on which the final rules are published in the *Federal Register*.

Mortgage Reform and Predatory Lending Act. Many of the mortgage-industry specific changes of the Dodd-Frank Act are included in Title XIV, which is entitled the “Mortgage Reform and Predatory Lending Act” (Mortgage Reform Act). The Mortgage Reform Act provides that the regulations required to be prescribed under Act or the amendments made by the Act shall (1) be prescribed in final form before the end of the 18-month period beginning on the designated transfer date, and (2) take effect not later than 12 months after the date of issuance of the regulations in final form. The Mortgage Reform Act further provides that a section of the Act shall take effect on the date on which the final regulations implementing the section take effect; however, a section for which regulations have not been issued on the date that is 18 months after the designated transfer date shall take effect on such date.

Mortgage Originator Definition. The Mortgage Reform Act amends TILA to define a “mortgage originator” as any person who, for direct or indirect compensation or gain, or in the expectation of direct or indirect compensation or gain (1) takes a residential mortgage loan application, (2) assists a consumer in obtaining or applying to obtain a residential mortgage loan, or (3) offers or negotiates terms of a residential mortgage loan. A mortgage originator specifically includes any person who represents to the public, through advertising or other means of communicating or providing information that such person can or will provide any of the services or perform any of the activities set forth in the definition of “mortgage originator.” A mortgage originator does not include:

- A person who performs purely administrative or clerical tasks on behalf of a mortgage originator.
- A person or entity that only performs real estate brokerage activities and is licensed or registered in accordance with applicable state law, unless the person or entity is compensated by a lender, mortgage broker or other mortgage originator or an agent of a lender, mortgage broker or mortgage originator.
- Subject to certain conditions, with respect to a residential mortgage loan, a person, estate or trust that provides mortgage financing for the sale of three properties in any 12-month period to purchasers of such properties, each of which is owned by the person, estate or trust and serves as security for the loan.
- A servicer or employees, agents and contractors of a servicer, including without limitation those who offer or negotiate terms of a residential mortgage loan for purposes of renegotiating, modifying,

replacing and subordinating principal of existing mortgages when the borrowers are behind in their payments, in default or have a reasonable likelihood of being in default or falling behind in their payments.

- For purposes of the mortgage originator prohibitions related to yield spread premiums and dual compensation that are addressed below, the creditor (except in a table funded transaction).

Mortgage Originator Compensation and Steering Prohibitions. As noted above, for purposes of the mortgage originator prohibitions related to yield spread premiums and dual compensation, the creditor is not a mortgage originator (except in a table funded transaction).

The Mortgage Reform Act amends TILA to provide that for any mortgage loan, a mortgage originator may not receive from any person and no person shall pay to a mortgage originator, directly or indirectly, compensation that varies based on the terms of the loan, other than the principal amount of the loan. Thus, yield spread premiums, overages and similar forms of compensation will be prohibited. Additionally, for any mortgage loan, (1) a mortgage originator may not receive from any person other than the consumer and (2) no person, other than the consumer, who knows or has reason to know that a consumer has directly compensated or will directly compensate a mortgage originator, may pay a mortgage originator any origination fee or charge except bona fide third party charges not retained by the creditor, mortgage originator or an affiliate of the creditor or mortgage originator.

Notwithstanding the prohibitions on compensation, a mortgage originator may receive an origination fee or charge from a person other than the consumer, and a person other than the consumer may pay an origination fee or charge to a mortgage originator, if the following conditions are satisfied:

- The mortgage originator does not receive any compensation directly from the consumer; and
- The consumer does not make an upfront payment of discount points, origination points or fees, however denominated, other than bona fide third party charges not retained by the mortgage originator, creditor, or an affiliate of the creditor or originator. By rule, waivers or exemptions to this condition may be made if it is determined that the waiver or exemption is in the interest of consumers and in the public interest.

By regulations, mortgage originators will be prohibited from:

- Steering any consumer to a residential mortgage loan that (1) the consumer lacks a reasonable ability to repay, in accordance with regulations that the Mortgage Reform Act requires be adopted regarding a required determination of repayment ability (which requirement is addressed below), or (2) has predatory characteristics or effects, such as equity stripping, excessive fees or abusive terms.
- Steering any consumer from a residential mortgage loan for which the consumer is qualified that is a qualified mortgage to a residential mortgage loan that is not a qualified mortgage.
- Engaging in abusive or unfair lending practices that promote disparities among consumers of equal credit worthiness but of different race, ethnicity, gender or age.
- Mischaracterizing the credit history of a consumer or the residential mortgage loans available to a consumer.
- Mischaracterizing or suborning the mischaracterization of the appraised value of the property securing the extension of credit.
- If the mortgage originator is “unable to suggest, offer or recommend to a consumer a loan that is not more expensive than a loan for which the consumer qualifies,” discouraging the consumer from

seeking a home mortgage loan secured by a consumer's principal dwelling from another mortgage originator.

The mortgage originator provisions may not be construed as:

- Permitting any yield spread premium or other similar compensation that would, for any mortgage loan, permit the total amount of the direct and indirect compensation from all sources permitted to a mortgage originator to vary based on the terms of the loan, other than the principal amount.
- Limiting or affecting the amount of compensation received by a creditor upon the sale of a consummated loan to a subsequent purchaser.
- Restricting a consumer's ability to finance, at the option of the consumer, including through the principal or rate, any origination fees or costs permitted under the restrictions on mortgage originator compensation, or the mortgage originator's right to receive such fees or costs (including compensation) from any person, subject to the origination fee exception described above, so long as the fees or costs do not vary based on the terms of the loan (other than the principal amount) or the consumer's decision about whether to finance such fees or costs.
- Prohibiting incentive payments to a mortgage originator based on the number of residential mortgage loans originated within a specified period of time.

Repayment Ability Determination. The Mortgage Reform Act amends TILA to require that a creditor may not make a residential mortgage loan unless the creditor, in accordance with regulations to be adopted by the CFPB, makes a reasonable and good faith determination based on verified and documented information that at the time the loan is consummated the consumer has the ability to repay the loan according to its terms, and all applicable taxes, insurance and assessments. If the creditor knows or has reason to know that more than one residential mortgage loan secured by the same property will be made to the same consumer, the repayment ability determination requirements apply to the combined payments on all loans. The Mortgage Reform Act sets forth general requirements for a repayment ability determination, and also special requirements for interest only loans or variable rate loans that permit the consumer to defer repayment of principal or interest. No regulation, order or guidance issued by the CFPB pursuant to the Mortgage Reform Act may be construed as requiring a depository institution to apply mortgage underwriting standards that do not meet the minimum underwriting standards required by the appropriate prudential regulator of the depository institution.

With respect to Federal Housing Administration (FHA) insured loans, Department of Veterans Affairs (VA) guaranteed loans, Department of Agriculture (USDA) guaranteed loans and Rural Housing Service (RHS) guaranteed loans, the applicable agencies may exempt refinancings for current borrowers under a streamlined refinancing from the income verification requirement, subject to certain conditions.

- *Qualified Mortgage.* For a qualified mortgage there would be a presumption of compliance with the ability to repay determination requirement. A "qualified mortgage" is defined by the Mortgage Reform Act basically to be a fully amortizing loan with a term that does not exceed 30 years (except as may be allowed in certain cases) that meets conditions, including that:
 - The income and financial resources relied upon to qualify the borrower are verified and documented.
 - For a fixed rate loan, the underwriting process is based on a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance and assessments.

- For an adjustable rate loan, the underwriting process is based on the maximum rate permitted under the loan during the first five years, and a payment schedule that fully amortizes the loan over the loan term and takes into account all applicable taxes, insurance and assessments.
- The consumer's monthly debts, including the amounts under the mortgage loan, will not exceed a certain percentage, established by regulation, of the consumer's monthly gross income, or other limits that may be established by regulation.
- The total points and fees would not exceed three percent of the total loan amount.
 - Points and fees would be as defined for purposes of the Home Ownership and Equity Protection Act (HOEPA), other than bona fide third party charges not retained by the mortgage originator or creditor or an affiliate of the mortgage originator or creditor. Up to two bona fide discount points on the loan could be excluded from the points and fees if the pre-discounted interest rate on the loan did not exceed the average prime offer rate by more than one percentage point, or up to one bona fide discount point on the loan could be excluded from the points and fees if the pre-discounted interest rate on the loan did not exceed the average prime offer rate by more than two percentage points.
- Reverse mortgages meeting certain conditions could be qualified mortgages. Also, FHA insured loans, VA guaranteed loans, USDA guaranteed loans and RHS guaranteed loans to be identified by regulation would be qualified mortgage loans. Balloon loans made by creditors that operate predominately in rural or underserved areas could be qualified mortgage loans if certain conditions are satisfied.
- *Foreclosure Defense.* A consumer could assert a failure to comply with the repayment ability determination requirements as a defense to a foreclosure or other action to collect the debt by the creditor.

Prepayment Penalties. The Mortgage Reform Act amends the TILA to prohibit prepayment penalties for mortgage loans that are not qualified mortgages. For purposes of the prohibition a qualified mortgage would not include (1) an adjustable rate loan or (2) a loan with an annual percentage rate that exceeds (a) by 1.5 or more percentage points the average prime offer rate for a comparable transaction, if the loan is a first lien non-jumbo loan, (b) by 2.5 or more percentage points the average prime offer rate for a comparable transaction, if the loan is a first lien jumbo loan, or (c) by 3.5 or more percentage points the average prime offer rate for a comparable transaction, if the loan is a subordinate lien loan. Whether a loan is or is not a jumbo loan would be based on the standard principal balance limits set forth in section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act.

A qualified mortgage may provide for a prepayment penalty in the 3-2-1 format. That is, the penalty could not be more than three percentage points, two percentage points or one percentage point of the outstanding loan balance for a prepayment during the first year, second year or third year of the loan, respectively. Additionally, a creditor could not offer a qualified mortgage with a prepayment penalty unless the creditor also offers a loan without a prepayment penalty.

TILA Liability. A number of provisions, including the mortgage originator steering prohibitions, repayment ability determination requirements and prepayment penalty restrictions, are subject to an expanded three-year statute of limitations for civil actions, and not the standard one-year statute of limitations. Also, the damage cap for class actions is modified from the lesser of \$500,000 or one percent of the creditor's net worth to the lesser of \$1 million or one percent of the creditor's net worth. A creditor or assignee of a residential mortgage loan will be exempt from liability to an obligor under TILA Section 130 if the obligor or co-obligor has been convicted of obtaining the loan by actual fraud.

Negative Amortization. The Mortgage Reform Act prohibits a creditor from making a residential mortgage loan that provides for negative amortization, other than a reverse mortgage loan, unless a disclosure is provided to the consumer that explains the negative amortization feature and describes

negative amortization in a manner to be prescribed by regulation. For a first-time homebuyer, the creditor also would have to obtain sufficient documentation to demonstrate that the consumer received homeownership counseling from a HUD-certified counselor.

Additional TILA Statement Disclosures. The Mortgage Reform Act amends TILA to require with any consumer credit transaction, other than an open-end or reverse mortgage transaction, secured by a first lien on the principal dwelling of a consumer for which an escrow or impound account for the payment of taxes, insurance or other periodic items is established that the payment schedule in a TILA disclosure take into account the amount of any monthly payment to the account in accordance with the escrow account requirements of RESPA. The Mortgage Reform Act requires that the following additional disclosures be included in a TILA disclosure for a residential mortgage loan:

- For a variable rate loan for which an escrow or impound account will be established for the payment of all applicable taxes, insurance and assessments:
 - The amount of the initial monthly payment due under the loan for the payment of principal and interest.
 - The amount of the initial monthly payment including the monthly payment deposited in the account for the payment of all applicable taxes, insurance and assessments.
 - The amount of the fully indexed monthly payment due under the loan for the payment of principal and interest.
 - The amount of the fully indexed monthly payment including the monthly payment deposited in the account for the payment of all applicable taxes, insurance and assessments.
- The aggregate amount of settlement charges for all settlement services provided in connection with the loan, the amount of charges that are included in the loan and the amount of such charges the borrower must pay at closing.
- The approximate amount of the wholesale rate of funds in connection with the loan, and the aggregate amount of other fees or required payments in connection with the loan.
- The aggregate amount paid to the mortgage originator in connection with the loan, the amount of such fees paid directly by the consumer, and any additional amount received by the originator from the creditor.
- The total amount of interest that the consumer will pay over the life of the loan as a percentage of the principal of the loan.

Hybrid Loan Adjustment Notice. The Mortgage Reform Act amends TILA to require the creditor or servicer of a hybrid adjustable rate mortgage loan to provide the borrower with notice of the impending rate adjustment during the one-month period that is six months before the rate is scheduled to adjust or reset. If the rate will adjust or reset within the first six months of the mortgage loan, the notice must be provided at consummation. The notice must be separate and distinct from all other correspondence to the consumer and include certain information, including information regarding the impending rate change, a good faith estimate of the payment that will be required after the change and alternatives the consumer may pursue, including refinancing. For purposes of the notice requirement, a hybrid adjustable rate mortgage loan is a consumer credit transaction secured by a consumer's principal residence with a fixed interest rate for an introductory period that adjusts or resets to a variable rate of interest after such period.

Monthly Statements. For a residential mortgage loan, the Mortgage Reform Act requires that the creditor, assignee or servicer provide the consumer with a monthly statement that contains various information, including information regarding the date of the next rate adjustment, the applicable

prepayment fee, contact information to obtain information on the loan, and information regarding housing counseling agencies or programs. Fixed rate mortgage loans are exempt from the monthly statement requirement if the borrower is provided with a coupon book that includes substantially the same information.

Net Tangible Benefit. The bill considered by the House and Senate conferees included a concept that a refinance loan must provide a net tangible benefit. What would constitute a net tangible benefit was not defined—that was left to regulations that would have been required. The net tangible benefit concept is not included in the Dodd-Frank Act.

HOEPA Loans. A number of changes are made regarding HOEPA loans, including changes to the triggers for being a HOEPA loan.

- *Annual Percentage Rate Trigger.* The Mortgage Reform Act changes the benchmark rate used to determine a HOEPA loan based on the annual percentage trigger from the yield on U.S. Treasury securities having a comparable maturity to the average prime offer rate. For first lien loans the annual percentage rate trigger is a rate that exceeds by more than 6.5 percentage points the average prime offer rate for a comparable transaction (or 8.5 percentage points if the dwelling is personal property and the transaction is for less than \$50,000). For subordinate lien loans the annual percentage rate trigger is a rate that exceeds by more than 8.5 percentage points the average prime offer rate for a comparable transaction. The 6.5 percentage point threshold for first lien loans may be changed by regulation but may not be less than six percentage points nor more than 10 percentage points. The 8.5 percentage point threshold for subordinate lien loans may be changed by regulation but may not be less than eight percentage points nor more than 12 percentage points. The annual percentage rate will be determined as follows:
 - For a fixed rate loan in which the annual percentage rate will not vary during the loan term, the annual percentage rate shall be determined based on the interest rate in effect on the date of consummation of the transaction.
 - For an adjustable rate loan in which the interest rate varies solely in accordance with an index, the annual percentage rate shall be determined based on the interest rate equal to the index rate in effect on the date of consummation plus the maximum margin permitted at any time during the loan agreement.
 - For any other transaction in which the rate may vary at any time during the loan term for any reason, the annual percentage rate shall be determined based on the interest charged on the transaction at the maximum rate that may be charged during the loan term.
- *Points and Fees Trigger.* The points and fees trigger to be a HOEPA loan also is revised by the Mortgage Reform Act. For a transaction of \$20,000 or more the trigger is five percent of the total transaction amount, and for a transaction of less than \$20,000 the trigger is the lesser of eight percent of the total transaction amount or \$1,000 (or such other dollar threshold as established by regulation). Additionally, the HOEPA provisions regarding points and fees are modified to:
 - Exclude mortgage insurance premiums for government loans and any mortgage insurance premiums paid by the consumer after closing.
 - Expand the mortgage broker compensation included in points and fees to all compensation paid directly or indirectly by a consumer or creditor to a mortgage originator from any source, including a mortgage originator that is also the creditor in a table funded transaction. (Currently HOEPA provides for the inclusion of all compensation paid to mortgage brokers, but the Regulation Z Commentary excludes mortgage broker fees already included in the calculation of the finance charge, such as a yield spread premium. As noted above, yield spread premiums and similar compensation based on the loan terms are prohibited by the Mortgage Reform Act.)

- Include premiums or other charges payable at or before closing for credit life, credit disability, credit unemployment or credit property insurance, or any other accident, loss-of-income, life or health insurance, or any payments directly or indirectly for any debt cancellation or suspension agreement or contract, except that insurance premiums or debt cancellation or suspension fees calculated and paid in full on a monthly basis shall not be considered financed by the creditor. (Currently HOEPA does not include such items in the points and fees but Regulation Z includes similar items in the points and fees.)
- Include the maximum prepayment fees and penalties that may be imposed on the new credit transaction.
- Include the prepayment fees or penalties incurred by the consumer on the existing loan if the new loan refinances a previous loan made or currently held by the same creditor or an affiliate of the creditor.
- Exclude certain bona fide discount points from the points and fees.
- *Prepayment Fee Trigger.* A new prepayment fee trigger is added. A prepayment fee will trigger HOEPA loan status if the prepayment fee may be imposed more than 36 months after closing, or if the prepayment fee exceeds more than two percent of the amount prepaid.
- *Open-End Exclusion Removed.* The exclusion of open-end credit transactions from being subject to HOEPA is removed. Reverse mortgage loans remain excluded from HOEPA. For open-end transactions, the points and fees are calculated by adding the total points and fees known at or before closing, including the maximum prepayment penalties that may be charged or collected under the terms of the credit transaction, plus the minimum additional fees the consumer would be required to pay to draw down an amount equal to the total credit line.
- *HOEPA Loan Terms and Other Changes.* The Mortgage Reform Act also makes various changes regarding terms of, and arrangements with, HOEPA loans. Among other changes:
 - The restriction on prepayment penalties is removed; however, as noted above the Mortgage Reform Act imposes a general prohibition on prepayment penalties for loans that are not qualified mortgages.
 - The prohibition on balloon payments is modified to apply to all HOEPA loans, and not just HOEPA loans with a term of less than 5 years. The restriction will not apply when the payment schedule is adjusted to the seasonal or irregular income of the borrower.
 - The financing of points and fees or the financing of prepayment fees or penalties is prohibited when the creditor or its affiliate is the note holder of the loan being refinanced.
 - Charging the consumer a fee to modify, renew, extend or amend a HOEPA loan, or to defer any payment due under the terms of a HOEPA loan, is prohibited.
 - Making a HOEPA loan without obtaining certification from a HUD-approved counselor (or, at HUD's discretion, a state housing finance authority) that the consumer has received counseling on the advisability of the loan is prohibited (and the counselor must not be an employee or affiliate of, or affiliated with, the creditor).
 - A creditor may not recommend or encourage default on an existing loan or other debt prior to and in connection with the closing or planned closing or a HOEPA loan that refinances all or any portion of the existing loan or debt.
 - In addition to other restrictions, late fees are limited to four percent of the payment amount that is past due.

- *Cure Procedure.* Significantly, the Mortgage Reform Act adds a cure procedure for HOEPA loans. A creditor or assignee of a HOEPA loan who, when acting in good faith, fails to comply with any requirement under TILA section 129 will not be deemed to have violated the requirement if the creditor or assignee establishes that either:
 - Within 30 days of the loan closing and prior to the institution of any action, the consumer is notified of or discovers the violation, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the consumer—
 - Make the loan satisfy the applicable requirements of TILA; or
 - In the case of a HOEPA loan, change the terms of the loan in a manner beneficial to the consumer so that the loan will no longer be a HOEPA loan; or
 - Within 60 days of the creditor’s discovery or receipt of notification of an unintentional violation or bona fide error and prior to the institution of any action, the consumer is notified of the compliance failure, appropriate restitution is made, and whatever adjustments are necessary are made to the loan to either, at the choice of the consumer—
 - Make the loan satisfy the applicable requirements of TILA; or
 - In the case of a HOEPA loan, change the terms of the loan in a manner beneficial to the consumer so that the loan will no longer be a HOEPA loan.

Escrow/Impound Requirements. Subject to exceptions, the Mortgage Reform Act amends TILA to require a creditor with a closed-end consumer credit transaction secured by a first lien on a consumer’s principal dwelling to establish before consummation of the transaction an escrow or impound account for the payment of taxes and hazard insurance and, if applicable, flood insurance, mortgage insurance, ground rents and any other required periodic payments or premiums with respect to the property or the loan terms. In cases in which an escrow or impound account is required by the Mortgage Reform Act, the account would need to be maintained for at least five years, but could be terminated in less than five years if the borrower has sufficient equity in the dwelling that secures the transaction such that the borrower is no longer required to maintain private mortgage insurance. When an escrow or impound account will be required by the Mortgage Reform Act, the creditor must provide a disclosure to the borrower at least three business days before consummation that sets forth the requirement for the account and related information. A creditor also will be required to provide a notice of the consumer’s responsibilities and the implications for the consumer in cases in which an escrow or impound account will not be established or an account will be closed.

TILA Servicing Requirements. The Mortgage Reform Act adds requirements to TILA that are similar to the servicing requirements that the Federal Reserve Board added to Regulation Z effective October 1, 2009, regarding the crediting of payments and the provision of payoff statements. Specifically, the Mortgage Reform Act provides that:

- In connection with a consumer credit transaction secured by a consumer’s principal dwelling, the servicer must credit a payment to the consumer’s loan account as of the date of receipt, except when a delay in crediting does not result in any charge to the consumer or in the reporting of negative information to a consumer reporting agency. If a servicer specifies in writing requirements for the consumer to follow in making payments, but accepts a payment that does not conform to the requirements, the servicer must credit the payment as of five days after receipt.
- A creditor or servicer of a home loan must send an accurate payoff balance within a reasonable time, but in no case more than seven business days, after the receipt of a written request for such balance from or on behalf of the borrower. Currently, the Regulation Z Commentary provides that five business days generally is considered a reasonable time to provide a payoff statement.

RESPA Servicing Requirements. The Mortgage Reform Act amends the qualified written request provisions of RESPA to reduce the time to acknowledge receipt of a qualified written request from 20 to five business days and to reduce the time to act on the qualified written request from 60 to 30 business days, although a 15 day extension is permitted under certain circumstances. Additionally, the Mortgage Reform Act:

- Prohibits the imposition of a fee by a servicer for responding to “valid qualified written requests”, to be defined by the CFPB.
- Requires that upon the payoff of a loan the servicer must within 20 business days return the escrow account balance to the borrower or credit the balance to a similar account for a new mortgage loan with the same lender.
- Prohibits the forced-placement of insurance by a servicer unless there is a reasonable basis to believe the borrower failed to comply with the loan contract’s requirements to maintain property insurance, and imposes requirements in connection with the forced-placement of insurance.
- Requires a servicer to respond within 10 business days to a request from a borrower to provide the identity, address and other relevant contact information about the owner or assignee of the loan.
- Modifies the damage limits for failure to comply with the RESPA servicing requirements by increasing the additional damages cap from \$1,000 to \$2,000, and by increasing the aggregate additional damages cap in a class action from the lesser of \$500,000 or one percent of the net worth of the servicer to the lesser of \$1 million or one percent of the net worth of the servicer.

Appraisals.

- *Appraiser Independence.* The Mortgage Reform Act amends TILA to add appraiser independence requirements for mortgage loans secured by a principal dwelling that are similar to the appraiser independence provisions in Regulation Z that became effective on October 1, 2009. Interim final regulations under the TILA requirements must be prescribed within 90 days after the Dodd-Frank Act became law, and rules, interpretive guidelines and general statements of policy with respect to acts or practices that violate the requirements are authorized. On the date that the interim final regulations are promulgated, the Home Valuation Code of Conduct will have no force or effect. The Mortgage Reform Act also makes various changes to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) regarding the independence, qualifications and monitoring of appraisers.
- *Appraisal Report Portability.* The Mortgage Reform Act authorizes regulations that address the issue of appraisal report portability, including regulations that ensure the portability of the appraisal report between lenders for a consumer credit transaction secured by a one- to four-unit single family residence that is the principal dwelling of the consumer, or mortgage brokerage services for such a transaction.
- *Compensation of Appraisers.* The Mortgage Reform Act requires that lenders and their agents compensate fee appraisers at a rate that is customary and reasonable for appraisal services performed in the market area of the property being appraised.
- *Appraisal Management Companies.* The Mortgage Reform Act amends FIRREA to require the adoption of regulations that establish minimum requirements to be applied by a state in the registration of appraisal management companies, and the creation by the Appraisal Subcommittee of the FFIEC of a national registry for appraisal management companies that either are registered with and subject to supervision of a state appraiser certifying and licensing agency or are operating subsidiaries of a federally regulated financial institution. Following the date that is 36 months after the date on which the regulations are prescribed in final form, an appraisal management company

may not perform services related to a federally related transaction in a state unless the company is registered with the state or subject to oversight by a federal financial institution regulatory agency. The 36-month period may be extended up to 12 months to provide for registration and supervision of appraisal management companies in a state if there is a finding that the state has made substantial progress in establishing a state appraisal management company registration and supervision system that appears to conform with the requirements of the Mortgage Reform Act. Appraisal management companies would have to pay a registry fee of at least \$25 per appraiser working for or contracting with the company in a given state, and the fee could be adjusted to a maximum of \$50 per appraiser.

- An “appraisal management company” is defined to mean, in connection with valuing properties collateralizing mortgage loans or mortgages incorporated into a securitization, any external third party authorized either by a creditor of a consumer credit transaction secured by a consumer’s principal dwelling or by an underwriter of or other principal in the secondary mortgage markets, that oversees a network or panel of more than 15 certified or licensed appraisers in a state or 25 or more nationally within a given year to (1) recruit, select and retain appraisers, (2) contract with licensed and certified appraisers to perform appraisal assignments, (3) manage the process of having an appraisal performed, including providing administrative duties such as receiving appraisal orders and appraisal reports, submitting completed appraisal reports to creditors and underwriters, collecting fees from creditors and underwriters for services provided, and reimbursing appraisers for services performed, or (4) review and verify the work of appraisers.
- *Disclosure of Appraisal Fee.* The Mortgage Reform Act amends RESPA to provide for the separate disclosure in the HUD-1 settlement statement of the fee paid to the appraiser by an appraisal management company and the administrative fee charged by the appraisal management company. The position HUD set forth in the April 2, 2010 version of the Frequently Asked Questions on the new RESPA rules provides that when an appraisal is ordered through an appraisal management company, the line in the HUD-1 Settlement Statement for the appraisal need only show the appraisal management company.
- *Automated Valuation Models.* The Mortgage Reform Act amends FIRREA to provide that automated valuation models must adhere to quality control standards designed to (1) ensure a high level of confidence in the estimates provided by the models, (2) protect against the manipulation of data, (3) seek to avoid conflicts of interest, (4) require random sample testing and reviews, and (5) account for any other such factor that the applicable federal agencies determine to be appropriate. An “automated valuation model” is defined as “any computerized model used by mortgage originators and secondary market issuers to determine the collateral worth of a mortgage secured by a consumer’s principal dwelling.”
- *Broker Price Opinions.* The Mortgage Reform Act amends FIRREA to provide that in connection with a consumer’s purchase of his or her principal dwelling, broker price opinions may not be used as the primary basis to determine the value of the property for the purpose of originating a residential mortgage loan to be secured by the property. A “broker price opinion” is defined as “an estimate prepared by a real estate broker, agent, or sales person that details that probable selling price of a particular piece of real estate property and provides a varying level of detail about the property’s conditions, market, and neighborhood, and information on comparable sales. . . .” An automated valuation model is excluded from the definition of a “broker price opinion.”
- *Copy of Appraisal.* The Mortgage Reform Act expands the provisions of the Equal Credit Opportunity Act (ECOA) regarding appraisals to require that a creditor furnish to an applicant a copy of any and all written appraisals and valuations developed in connection with the applicant’s application for a loan that is or would have been secured by a first lien on a dwelling. A copy of each appraisal or valuation must be furnished promptly upon completion and in no case later than three days before the closing of the loan. A copy of each the appraisal or valuation must be

provided whether the creditor grants or denies the application, the applicant withdraws the application or the application is incomplete. The applicant may waive the three-day delivery requirement, except when such a waiver would not be permitted by law. The applicant may be required to reimburse the creditor for the cost of the appraisal, but a copy of each appraisal or valuation must be provided at no additional cost.

- *Appraisals Required for Higher-Risk Mortgages.* The Mortgage Reform Act amends TILA to prohibit a creditor from extending credit in the form of a higher-risk mortgage to any consumer without first obtaining a written appraisal of the proposed security property that satisfies certain conditions. The creditor must provide the consumer with a copy of each appraisal, without charge, at least three days before the transaction closing date. For purposes of the requirement, a “higher-risk mortgage” is defined as a residential mortgage, other than a reverse mortgage that is a qualified mortgage loan, secured by a principal dwelling that (1) is not a qualified mortgage and (2) has an annual percentage rate that exceeds (a) by 1.5 or more percentage points the average prime offer rate for a comparable transaction, if the loan is a first lien non-jumbo loan, (b) by 2.5 or more percentage points the average prime offer rate for a comparable transaction, if the loan is a first lien jumbo loan, or (c) by 3.5 or more percentage points the average prime offer rate for a comparable transaction, if the loan is a subordinate lien loan. Whether a loan is or is not a jumbo loan would be based on the standard principal balance limits set forth in section 305(a)(2) of the Federal Home Loan Mortgage Corporation Act.

S.A.F.E. Act. The Dodd-Frank Act amends the Secure and Fair Enforcement for Mortgage Licensing Act (S.A.F.E. Act) by moving the enforcement and rulemaking authority under the S.A.F.E. Act from HUD to the CFPB. The CFPB is charged with developing and maintaining a system for registering loan originators who work for depository institutions or subsidiaries of depository institutions that are regulated by a federal banking agency or the Farm Credit Administration with the Nationwide Mortgage Licensing System (NMLS). The system must be implemented before the end of one year from the date the Dodd-Frank Act became law.

- *Regulations.* A new provision added to the S.A.F.E. Act authorizes the CFPB to promulgate regulations setting forth minimum net worth or surety bond requirements for residential mortgage loan originators and minimum requirements for recovery funds paid into by loan originators. Note that the S.A.F.E. Act does not define “residential mortgage originator”, and instead speaks to “mortgage originators” and “registered mortgage originators.” It is not clear if this regulatory authority is intended to cover all mortgage originators or just “registered mortgage originators”, which are employees of federally regulated depository institutions or their subsidiaries and entities regulated by the Farm Credit Administration.
- *Mortgage Originators.* As noted above, the Mortgage Reform Act also amends TILA to incorporate a definition of mortgage originator and impose certain duties upon originators. Certain important differences exist between the S.A.F.E. Act definition of “mortgage originator” and the definition under the Mortgage Reform Act. The Mortgage Reform Act adds as one of the activities that a mortgage originator conducts “assist[ing] a consumer in obtaining or applying to obtain a residential mortgage loan.” Additionally, the definition in the Mortgage Reform Act links the activities of a mortgage originator by use of the word “or” rather than “and”, which is used in S.A.F.E. Act. The Mortgage Reform Act excludes a number of additional people from the definition of “mortgage originator”, including: (1) employees of a retailer of manufactured homes who do not advise a consumer on loan terms (note, many state versions of the S.A.F.E. Act already included this provision); (2) persons, estates or trusts that provides mortgage financing for the sale of three properties in any 12-month period to purchasers of such properties, each of which is owned by such person, estate or trust and serves as security for the loan, provided certain conditions are met; (3) creditors in the transaction (other than creditors in a table-funded transaction); and (4) servicers or servicer employees, agents and contractors, including those that provide loan modifications where the borrower is behind in payments, in default or has a reasonable likelihood of being in default.

- *Registration, Licensing and Identifier.* The Mortgage Reform Act provides that, subject to regulations, mortgage originators must be qualified and, when required, registered and licensed in accordance with applicable state and federal law, including the S.A.F.E. Act. Mortgage originators must also include their unique NMLS identifier on all loan documents. The inclusion of the NMLS identifier is not required by the S.A.F.E. Act, but many states have incorporated this concept into their version of the law.
- *Residential Mortgage Loan.* The definition of “residential mortgage loan” added to TILA by the Mortgage Reform Act does not contain language limiting the term to loans made for personal, family or household use, as is the case in the S.A.F.E. Act definition.

Home Mortgage Disclosure Act. The Dodd-Frank Act amends the Home Mortgage Disclosure Act (HMDA) to expand the data reporting requirements. Additional reporting requirements include:

- The credit score of the borrower or applicant, in such form as the CFPB may prescribe.
- The age of the borrower or applicant.
- The total points and fees payable at origination, as determined by the CFPB.
- The difference between the annual percentage rate for a loan and a benchmark rate (currently rate spread information must be reported only if the annual percentage rate exceeds the average prime offer rate for a comparable transaction by 1.5 percentage points for first lien loans or 3.5 percentage points for subordinate lien loans).
- The term in months of any prepayment penalty or other fee or charge payable on repayment of some portion of, or the entire, principal in advance of scheduled payments.
- The value of the real property securing the loan.
- The actual or proposed term in months of any introductory period after which the interest rate may change.
- The presence of contractual terms or proposed contractual terms that would allow the borrower or applicant to make payments other than fully amortizing payments during any portion of the loan term.
- The actual or proposed loan term.
- The channel through which the application was made, including retail, broker and other relevant categories.
- As the CFPB may determine to be appropriate, a unique identifier that identifies the loan originator as assigned pursuant to the S.A.F.E. Mortgage Licensing Act of 2008.
- As the CFPB may determine to be appropriate, the universal loan identifier.
- As the CFPB may determine to be appropriate, the parcel number that corresponds to the real property pledged or proposed to be pledged as collateral.
- Such other information as the CFPB may require.

HMDA reporting institutions will not be required to report the new data (except for age) before the first January 1 that occurs nine months after the date on which the CFPB issues regulations in final form with respect to the reporting of the new data. Regulations adopted by the CFPB, in consultation with

other agencies, can provide for modification of data that is or will be available to the public for the purpose of protecting the privacy interests of the borrowers or applicants.

Consumer Reports. The Dodd-Frank Act amends the Fair Credit Report Act (FCRA) to provide that if any person takes any adverse action with respect to any consumer that is based in whole or in part on any information in a consumer report (often referred to as a “credit report”), the person must provide the consumer written or electronic disclosure of a numerical credit score (as defined in the FCRA) used by the person in taking the adverse action and certain credit score information from the applicable consumer reporting agency (which currently is provided to consumers by users of consumer reports in connection with residential mortgage loan transactions).

Furnishers of Information. The Dodd-Frank Act also directs the CFPB to (1) establish and maintain guidelines for use by each person that furnishes information to a consumer reporting agency regarding the accuracy and integrity of the information related to consumers that such persons furnish to consumer reporting agencies, and to update the guidelines as often as necessary, and (2) prescribe regulations requiring each person that furnishes information to a consumer reporting agency to establish reasonable policies and procedures for implementing the guidelines.

Fannie Mae and Freddie Mac. The Dodd-Frank Act directs the Secretary of the Treasury to conduct a study of and develop recommendations regarding the options for ending the conservatorship of Fannie Mae and Freddie Mac while minimizing the cost to taxpayers. The Dodd-Frank Act identifies the following options to be considered: (1) the gradual wind-down and liquidation of the entities, (2) the privatization of the entities, (3) the incorporation of the functions of the entities into a federal agency, (4) the dissolution of Fannie Mae and Freddie Mac into smaller companies, and (5) any other measures the Secretary determines to be appropriate. The Obama Administration plans to deliver a comprehensive housing reform proposal to Congress in January 2011 that will address Fannie Mae and Freddie Mac.

Miscellaneous. The Mortgage Reform Act also provides for various additional changes, including the following.

- *Special Information Booklet.* The Special Information Booklet under RESPA is changed to the “Home Buying Booklet”. The Director of the CFPB must revise the Booklet at least once every five years, and prepare the Booklet in various languages and cultural styles as the Director deems appropriate, so that the Booklet is understandable and accessible to homebuyers of different ethnic and cultural backgrounds. The Booklet must take into consideration differences in real estate settlement procedures that may exist among the states and among separate political subdivisions within a state. The Director is required to distribute to lenders lists, organized by location, of certified homeownership counselors, and lenders would be required to provide with the Booklet a list of the certified homeownership counselors located in the lender’s area.
- *Home Inspections.* The HUD Secretary must take such actions as may be necessary or appropriate to inform potential homebuyers of the availability and importance of obtaining an independent home inspection. FHA approved mortgagees are required to provide prospective homebuyers with home inspection materials prepared by HUD.
- *Foreclosure Rescue Scams.* The Neighborhood Reinvestment Corporation, in consultation with servicers of residential mortgage loans, must use a portion of specific funds made available to HUD to inform borrowers regarding foreclosure rescue scams.